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SUBJECT: SCENESETTER FOR ASSISTANT SECRETARY OF STATE
PHILIP GORDON'S VISIT TO BAKU, JUNE 11-12

REF: BAKU 453

Classified By: Ambassador Anne E. Derse, for reasons 1.4 b and d

Summary

1. (C) Your visit to Baku comes on the heels of a successful visit by U.S. Special Envoy for Eurasian Energy Issues Morningstar and the June 4 meeting between the Armenian and Azerbaijani presidents in St. Petersburg. The mood here with respect to US-Azerbaijani relations remains skeptical, fed by suspicion that we are prepared to promote Turkey-Armenia reconciliation at the expense of resolution of the Nagorno-Karabakh (NK) conflict. Accusations of pro-Armenian bias in our policies and our mediation are increasingly sharp (reftel). The government also continues to react harshly to recent public USG criticism on press freedom. The war in Georgia and Turkish "betrayal" deepened Azerbaijan's sense of insecurity, but they reacted to Iran's protests over the planned late June visit of Israeli President Shimon Peres with renewed determination to go ahead with the visit. Your visit presents an opportunity to underscore again that as we manage the separate, but parallel, Turkey-Armenia and NK processes, we are committed to achieving progress on NK; and to begin to explore how we can move the relationship forward positively under the new Administration.

2. (C) Azerbaijan's leadership lately has been sharply critical of U.S. actions both publicly and privately. Through all of this, though, the GOAJ's determination to contribute to the Coalition effort in Afghanistan remains unchanged, and leaders want to engage with the United States in other military/security spheres. After winning a second term in October 2008 in an election that did not fully meet international standards but reflected popular support, President Aliyev has consolidated his domestic political position through a national referendum eliminating the two-term limit that would have forced him to leave office in 2013. The country is maintaining macroeconomic and social stability in the face of the global financial crisis, but has taken insufficient steps to reform its economy and root out corruption to ensure longer term sustainability. End Summary.

Turkey and Nagorno-Karabakh

3. (C) Azerbaijan's strategic direction is deeply affected by its physical security environment. Sandwiched between Russia and Iran, and with the unresolved Nagorno-Karabakh

conflict tying down 70 percent of its ground forces along the Line of Contact, Azerbaijan recognizes the need for strong allies. The August 2008 conflict in Georgia deepened Azerbaijan's sense of insecurity, and caused the GOAJ to re-examine Azerbaijan's strategic orientation. In the face of increasing Russian pressure and incentives, the GOAJ has asked the U.S. for significantly greater tangible support, both political and practical, to assure its security, independence and continued support for Western policies.

¶4. (SBU) GOAJ officials from the President down are unanimous that the resolution of the NK conflict is the country's top priority internally and externally. Beyond the obvious territorial and security concerns stemming from the conflict, NK is the one issue that unites the Azerbaijani public on a visceral level. Azerbaijan is willing to pursue a political track to solve the matter; however, any solution that does not guarantee the territorial integrity of Azerbaijan is anathema. Azerbaijani views on this issue have intensified in the context of Turkish-Armenian moves toward opening the border, and especially "de-linkage" of border opening plans from efforts to withdrawal Armenian forces from Azerbaijan's seven occupied territories, following the April 22 initialing of a Turkey-Armenia "roadmap." Since then, Azerbaijan has stepped up efforts to voice concerns about the reconciliation, complaining that Turkey and the United States failed to consult Baku and failed to take into account the effect of border opening on prospects for the negotiations to resolve NK. Azerbaijan expressed its displeasure with Ankara vocally and publicly, stating that relations between "one nation, two states" would be wrecked if borders opened

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without progress on NK resolution.

¶5. (SBU) Turkish PM Erdogan visited Baku May 13-14 and largely placated Azerbaijan's immediate concerns. Presidents Aliyev and Sargsian last met in Prague on the sidelines of the EU Eastern Partnership Meeting on May 7, and again in St. Petersburg on June 4, just before your visit. Preliminary reports from this meeting indicate that no major breakthroughs occurred, but there was some progress and clarification of points related to the Basic Principles, and an agreement to meet again soon. Your meetings are an opportunity to emphasize that the United States views Turkey-Armenia reconciliation and Nagorno-Karabakh resolution as separate but parallel processes and that we remain committed to supporting progress on NK. We also want to strongly reiterate the commitment of the United States to the Minsk Group peace process, under the auspices of OSCE.

Security Cooperation

¶6. (C) Azerbaijan has increased its defense spending tenfold in five years and now spends about 2 billion dollars annually on defense. While this rate of growth may sound alarming, it is tempered by the fact that it represents an approximate three percent of GDP, the Azerbaijani Army is in dire need of replacing or repairing many items and infrastructure, and the sum of money is spread across multiple "power" ministries, not just the MoD. Your GOAJ interlocutors will be unequivocal about Azerbaijan's orientation westward for its security needs, but they will just as forcefully argue that they need American weapons systems to build adequate defenses. Azerbaijanis complain bitterly about the restrictions of Section 907 of the Freedom Support Act, even though the waiver provision is applied, because of the "parity" policy on assistance to Armenia and Azerbaijan observed by Congressional appropriators. In recent months, they have demanded clarification of the Obama Administration's position on 907.

¶7. (C) Late last year Azerbaijan withdrew its 150-man contingent from Iraq, at the request of the Iraqi Government. (The Iraqi Government at that time asked most smaller

coalition contingents to depart.) Azerbaijan's troops had successfully partnered with U.S. Marines guarding the Haditha Dam. Since then, Azerbaijan has followed through on its commitment to double from 45 to 90 the size of its military contribution to Afghanistan, and is awaiting the Afghan Government's response to its proposal of increasing investment and civilian contributions such as construction of schools and training Afghan diplomats and police at its academies. Our first bilateral military exercise (REGIONAL RESPONSE 2009) occurred from April 15-28, 2009 and was a success for both sides; Azerbaijan also participated in NATO's annual Operation Longbow/Operation Lancer exercises, which took place in Georgia May 6) June 3, despite Russian pressure to withdraw from both exercises.

18. (SBU) Your interlocutors here will be keen to discuss developments in Afghanistan and Pakistan, and may offer additional areas for cooperation. Moreover, your visit is an opportunity to solidify further Azerbaijan's cooperation on regional security issues and counter-terrorism, and to build on Commander, EUCOM General Craddock's and Commander, USTRANSCOM General McNabb's efforts to develop more intensified cooperation on security, including a surface transport corridor linking Europe and the CENTCOM operational theaters. Azerbaijan is interested in providing a battalion for Afghanistan and engaging in a related train and equip program. They have asked for a team to come to Baku to explain the proposed missions and how a TEP would work.

Energy

19. (SBU) Energy is one of the three essential areas of United States engagement with Azerbaijan, along with security and political and economic reform. Azerbaijan's massive oil and gas reserves and strategic location place the country at the epicenter of Eurasia energy policy. This was highlighted June 2-5 with the Baku's Caspian Oil and Gas Show.

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Azerbaijan currently exports oil through two non-Russian pipelines to European markets (Baku-Supsa (Georgia/Black Sea) and Baku-Tbilisi-Ceyhan), in addition to the Baku-Novorossiysk (Russia/Black Sea) pipeline, and produces natural gas for export via Georgia and Turkey. As a producing and transit country, Azerbaijan is key to the development of a Southern Corridor to transport Caspian hydrocarbons, including Kazakh oil and Turkmen gas, to European and world markets. The one million barrel per day BTC pipeline was disrupted in August 2008 by an explosion in Turkey; days later the conflict began between Russia and Georgia. BTC was not damaged, but Russian bombing near Tbilisi did destroy a rail crossing vital to Baku's back-up transport plan. For this reason, as well as general vulnerabilities in the offshore sector, the USG has conveyed to the GOAJ the United States' interest in cooperating on critical energy infrastructure protection.

110. (C) Bilateral difficulties centering on the price of Azerbaijani gas now being sold to Turkey and the unwillingness of Turkey to grant transit to Azerbaijani gas that would be exported in the future to European markets have been the major obstacles to the success of the "Southern Corridor" project, which seeks to diversify routes for Caspian gas to European markets. Azerbaijan's recent frustration with Turkey related to reconciliation with Armenia intensified this problem, but progress was reported during the visit of Turkish Prime Minister Erdogan and new Turkish Minister of Energy Tanar Yildiz to Baku on May 13. In a June 4 meeting in Ankara, Yildiz told Ambassador Morningstar that an agreement on a Nabucco IGA would be reached in 2-3 weeks. Price remains the sticking point, but Yildiz said negotiations with Azerbaijan were going smoothly.

111. (SBU) Azerbaijan's oil production, amounts to almost 1 million barrels per day, mainly produced offshore by a

consortium led by British Petroleum (BP). International oil companies are urging Azerbaijan to conclude agreements with Kazakhstan to allow oil to flow by tanker to BTC from the mammoth North Caspian Kashagan field, which should come on line in 2013. Chevron has already begun shipping small volumes of oil from Kazakhstan's Tengiz field to BTC. In this connection, we are noting to the GOAJ that the goals of transparency, security and safety will be best served by including the International Energy Companies which are partners in the Kashagan and Tengiz fields in any cross-Caspian transportation arrangements.

Democracy and Reform

¶12. (SBU) The flawed October 2008 presidential election and especially the hastily conducted March 2009 referendum that made 41 changes to the Constitution, inter alia, to lift the two-term restriction on the President, underscored the slowing of Azerbaijan's democratic transition. The referendum in particular was arranged with lightning speed by the ruling party, with parliamentary approval, and Embassy observers reported widespread fraud during voting. However, the fraud appeared to be directed at padding the vote totals, and we assessed that especially considering the low bar that Azerbaijani law sets for the adoption of referendum measures, the Government would have succeeded in any event. The main opposition parties, which are generally weak and lack popular support, boycotted the October election and the referendum.

¶13. (SBU) Many observers believed that once he was secure in another five year term, President Ilham Aliyev would reach out to the opposition and tack back on to a moderate course on democratization and increased respect for human rights. This has not yet happened to a large extent, but there are some minor encouraging indicators. One prominent imprisoned journalist benefited from an amnesty and was released, and the President recently intervened to overturn the convictions of two other journalists who had been sentenced to prison and hard labor under a criminal libel statute. We are also informed that the GOAJ may coordinate the drafting of implementing legislation for the constitutional changes approved by the referendum with the Venice Commission of the Council of Europe. However, the media environment is still

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far from free, with USG-sponsored Radio Liberty and Voice of America broadcasts banned from FM airwaves as of January 1, after broadcasts from Russia and Turkey were similarly banned. The Council of Europe has appointed a Special Rapporteur on Political Prisoners, a German parliamentarian who is expected to visit the country in June. Lack of freedom of assembly is a large problem; nearly 100 young people were arrested on May 10 during several small events mourning the 13 victims of an April 30 shooting at the State Oil Academy.

¶14. (SBU) Should your Azerbaijani interlocutors raise any of these issues, you are certain to hear complaints that Azerbaijan is treated unfairly by the United States and Europe on human rights and democracy compared to Armenia and others. In particular, President Obama's statement on May 3 World Press Freedom Day, which placed Azerbaijan in the same phrase as Zimbabwe, particularly irked some GOAJ leaders including the President --especially as Russia and Iran, and other egregious violators of media freedom, were not mentioned. We need to continue to encourage reform and emphasize that security and stability are enhanced by, and depend on, the development of democracy and respect for human rights.

Economy Still Strong - For Now

¶15. (SBU) On the economic side, the business climate outside

the oil sector is challenging. Corruption and institutionalized monopolies remain serious roadblocks to further investment. Transparency International's Corruption Perceptions Index (as well as anecdotal evidence from American business contacts in Baku) confirms that Azerbaijan still has a long way to go in stamping out corruption. On the other hand, Azerbaijan is taking important steps to simplify its regulatory requirements, and for this reason the World Bank named it the world's "Number One Reformer" in its most recent "Doing Business" report. The WTO accession process could help bring about the legislative and regulatory changes needed to reform Azerbaijan's economy and introduce transparent, market-driven practices. President Aliyev pledged to support accelerating Azerbaijan's WTO accession in 2007 and, with the help of USAID, Azerbaijan has made significant progress towards accession.

¶16. (SBU) While no country is expected to completely escape the impact of the ongoing world economic crisis, the GOAJ believes that it is in an excellent position to withstand the difficulties of the crisis compared to other countries, thanks to mounting reserves at its Central Bank and State Oil Fund and its limited integration to the global financial system. High export receipts and fiscal revenue - the result of extremely rapid economic growth over the last three years - contributed to the strong foreign exchange and fiscal position of the country, which can be used to support demand if an economic slow-down becomes more severe. However, this assumes that expectations of devaluation, speculative for now, will not continue or accelerate. So far this year the CBA and the State Oil Fund have poured in over 3 billion manat to support the currency, which has appreciated against the dollar in recent years. Azerbaijan, which has roughly a USD 44 billion economy, held about 18 billion manat in net reserves as of December 2008. (Note: current exchange rate is 1 USD = manat 0.82.)

Comment

¶17. (C) Your visit is our first opportunity under the new administration to comprehensively review U.S.-Azerbaijan relations with the Foreign Minister. A visit this early in your tenure demonstrates the strategic importance the United States' accords relations with Azerbaijan at a moment of regional turbulence. It will help set the tone for our future engagement. The Azerbaijanis want to discuss the Obama Administration's approach to regional foreign relations, and in particular the Administration's views of Nagorno-Karabakh, Turkey-Armenia rapprochement, and Section 907 of the Freedom Support Act. In your meeting with the Foreign Minister, you will have an opportunity to build on

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the recent visits of General Craddock and General McNabb and explore further engagement on security cooperation. The Foreign Minister may inquire about weapons sales or security guarantees.

¶18. (C) Comment Continued: At the same time, it will be important to relay the USG's continuing interests in Azerbaijan's progress on democracy and human rights. We recommend you convey our expectation that the GOAJ will live up to its commitment to assist us in acquiring land to build a New Embassy Compound (NEC) in Baku. Progress has been stalled by recent political tensions. Enhanced security cooperation and energy sector development are the two most likely areas for improving relations, and on these fronts the GOAJ is prepared to talk.

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